# EITF Update

**EITF meeting highlights**

## March 2021 meeting highlights

In this issue:



Members of the Emerging Issues Task Force (EITF or Task Force) reached a final consensus on one issue. The final consensus is subject to ratification by the Financial Accounting Standards Board (FASB or Board) at the 24 March 2021 meeting.

The Task Force reached a final consensus on the following issue:

- Issue 19-C: The Task Force decided that issuers should account for modifications or exchanges (referred to collectively as modifications) of freestanding equity-classified written call options (e.g., warrants) based on the economic substance of the modification. That is, an issuer should consider the facts and circumstances to determine the accounting based on whether the modification was made (1) to issue equity, (2) to issue or modify debt or (3) for other reasons.

The Task Force also decided to refer Issue 19-B to the FASB for consideration at a public meeting. The FASB could decide to address Issue 19-B as part of its Post Implementation Review (PIR) of the revenue recognition guidance in Accounting Standards Codification (ASC) 606[1] or to address it narrowly in a new FASB project.

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## Final consensus

Issue 19-C: Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Forwards and Options

***What's the issue?***

*No authoritative guidance addresses how issuers should account for modifications of equity-classified freestanding written call options that are not in the scope of ASC 718*[2] *and that remain classified in equity after modification. This lack of guidance has caused diversity in accounting for these types of modifications.*

*Entities modify freestanding written call options, such as warrants, for different reasons. For example, entities may modify warrants in connection with the issuance of new debt or equity securities or a refinancing of existing debt. They also modify these instruments to compensate holders for services or goods or for other reasons, such as to provide value to a stockholder in lieu of a dividend.*

*In the absence of specific guidance on how to account for these modifications, entities analogize to other guidance. This can result in entities reaching different accounting conclusions for economically similar modifications. For example, entities that modify warrants in conjunction with an equity issuance may recognize the increase in fair value of the warrants resulting from the modification as an equity issuance cost that reduces additional paid-in capital, a deemed dividend charged to retained earnings or an immediate expense.*

The Task Force reached a final consensus that issuers should account for modifications of equity-classified freestanding written call options (e.g., warrants) that are not in the scope of another ASC topic, such as ASC 718 or ASC 606, based on the economic substance of the modification. That is, the accounting for these modifications should be based on the reasons for the modifications.

The Task Force also decided that the scope of the final consensus should be limited to modifications of equity-classified freestanding written call options. This means that the final consensus would not apply to modifications of equity-classified freestanding forward contracts or purchased options on an entity's own shares, for example.

Under the final consensus, an issuer would consider the facts and circumstances of a modification of an equity-classified freestanding written call option and apply the following guidance to account for the resulting change in fair value of the written call option, based on the reason for the modification:

- To issue equity: Any increase in fair value would be accounted for as an equity issuance cost that reduces additional paid-in capital under ASC 340-10-S99-1.
- To issue debt: Any increase in fair value would be accounted for as a debt issuance cost or a discount under ASC 835.[3]
- To modify debt: Any increase or decrease in fair value would be analyzed and recognized under the debt modification and extinguishment guidance in ASC 470-50[4] or the troubled debt restructuring guidance in ASC 470-60,[5] with the change in fair value included in the 10% cash flow test used to determine whether to account for a debt modification as an extinguishment or modification of the existing debt.
- For other reasons: Any increase in fair value would be accounted for as a deemed dividend that would reduce retained earnings and earnings per share, if the modification is not in the scope of any other topics.

*Effective date and transition*

Entities would apply the final consensus prospectively.

The final consensus would be effective for all entities for fiscal years beginning after 15 December 2021, and interim periods within those fiscal years. Early adoption, including early adoption in an interim period as of the beginning of the fiscal year that includes that interim period, would be permitted.

## Issues discussed

Issue 19-B: Revenue Recognition — Contract Modifications of Licenses of Intellectual Property

***What's the issue?***

*The guidance in ASC 606 is not clear on when revenue should be recognized if a modification of a license of intellectual property (IP) is not solely a renewal of the same terms and conditions as the original license. As a result, some entities believe that revenue for a license renewal should be recognized when the modification is approved by both the licensor and licensee, while others believe revenue should be recognized at the end of the original license term, which may be later than when the modification is approved.*

*The licensing guidance states that "an entity would not recognize revenue before the beginning of the license period even if the entity provides (or otherwise makes available) a copy of the intellectual property before the start of the license period or the customer has a copy of the intellectual property from another transaction.* ***For example, an entity would recognize revenue from a license renewal no earlier than the beginning of the renewal period.****" (Emphasis added.) The guidance also includes an example (Example 59) that illustrates the application of this guidance for a renewal of a license of IP under the same terms and conditions as the original license.*

*Because the licensing guidance doesn't address modifications that are not solely a renewal of the terms and conditions of the original license (e.g., the modification also adds other goods or services, the modification changes the pricing), questions have arisen about whether an entity is required to defer revenue recognition until the end of the original license term in these situations or whether it can recognize revenue earlier than the entity in the example in the guidance.*

*Questions have also arisen about how to account for a modification that includes a reduction in the rights conveyed by the license (e.g., the number of users of a license) or when the license is revoked (e.g., a software license is converted into a software-as-a-service arrangement).*

The Task Force decided to refer Issue 19-B to the FASB for consideration at a public meeting. The FASB could decide to address Issue 19-B as part of its PIR of ASC 606 or to address it narrowly in a new FASB project.

The FASB staff's preliminary PIR outreach on ASC 606 indicates that stakeholders find the licensing guidance to be complex and costly to apply, and the complexities extend beyond modifications of licenses. The FASB staff plans to perform additional PIR outreach with financial statement users on ASC 606, including the licensing guidance, during the first half of 2021.

**Endnotes:**

[1] ASC 606, *Revenue from Contracts with Customers*.

[2] ASC 718, *Compensation — Stock Compensation*.

[3] ASC 835, *Interest*.

[4] ASC 470-50, *Debt — Modifications and Extinguishments*.

[5] ASC 470-60, *Debt — Troubled Debt Restructurings by Debtors*.